

Risk management after an IPO

The essential guide for
new public companies



“Good risk management is based on knowing what the key risks are, what needs to be done about them and who is responsible.”

Introduction

Taking a business public can be a rollercoaster ride. But finally seeing the company’s ticker symbol on a trading screen is always a source of great pride. That’s when you know that months of hard work have paid off.

But this is not the end of the journey. A successful initial public offering (IPO) opens the door to some exciting business opportunities. Yet it also creates new challenges. Life is very different for a public company. The business will face a whole new set of risks that need to be managed and monitored effectively.

This brief guide will help newly public companies and those planning an IPO to understand how the business risks they face will change and prioritize actions for risk management improvement. It also explains how better risk management can not only help the business to avoid unpleasant “surprises” but also function as an important new source of value and advantage.

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1.

Why risk management matters

Successful companies understand the value of good risk management. The economic downturn has only served to underline this truth.

The global financial shocks we've experienced over the past few years have encouraged investors, regulators and other stakeholders to look far more closely at how effectively public companies manage risk.

Raising the quality of risk management has become a strategic priority. Even those that perform well in this regard have been taking additional steps to improve their systems and processes.

A company making the transition from private to public needs to be doubly sure that it understands its changing risk profile once the IPO process is complete. In the current environment, the markets will not look kindly on "surprise" announcements. Investors are likely to sell first and ask questions later. And regulators will direct greater attention at companies that cannot provide accurate information on demand.

Better risk management is better management

This increased focus on risk management is not necessarily a negative trend. The economic downturn has changed corporate attitudes to risk, with many companies and investors taking a more enlightened view. There is a growing appreciation that risk and opportunity are two sides of the same coin.

An effective approach to risk management has to strike the right balance between risk and opportunity. Companies need the flexibility to act quickly and take risks when profitable opportunities are identified, but they need to do so in a controlled way and within pre-established risk parameters.

Every business is different, so every business will balance these competing pressures in its own way. What's important is that the company determines the right mix at the highest level and communicates its thinking across the business.

Get this wrong, and the business will struggle to achieve its full potential and deliver on its pre-IPO promises. Get it right, and the business will accelerate its journey to market leadership, safe in the knowledge that it has an informed understanding of the risks and the opportunities that it may encounter along the way.

In this guide, we'll share with you:

1. How a strong risk management program can actually improve your business performance
2. Some of the leading practices that will help your organization to implement a risk management framework
3. How you can start to assess whether your organization's risk management program measures up

2.

The new risks facing a public company

Leading a post-IPO business is an exciting challenge. The capital needed to accelerate growth is now in place, and plans for taking the next steps to market leadership are being implemented. In this period of intense change, risk management should be high on the executive agenda.

Taking a company public is a risky venture, so executives may well be used to concentrating on threats and opportunities. But once the business has completed its IPO, the executive team needs to refocus its risk thinking. Attention has to shift from the risks and opportunities created by the IPO process to the new challenges and expectations facing the business now that it is public.

It is easy to underestimate the level of accountability and scrutiny the business will have to deal with. Securities regulators, governments, public stock exchanges, activist groups and shareholders will all have their own demands: responding to them in the right way will become part of daily life.

The business needs to adapt to this environment quickly. If executives become bogged down dealing with unforeseen risks, the business will find it harder to capitalize on the opportunities created by the IPO.

The months directly after an IPO can be a difficult time to raise the issue of risk management improvement. Executive resources are likely to be stretched as senior people focus on implementing their new strategic plans. Nevertheless, the ability to identify and manage risk is a vital element of success – both in the immediate post-IPO phase and into the future.

Keeping stakeholders happy

After a company goes public, management accountability shifts from a handful of investors to perhaps thousands of new stakeholders and owners. As the number of stakeholders multiplies, so do the company's responsibilities. They will now include:

- ▶ Meeting market expectations
- ▶ Being accountable for the use of IPO proceeds
- ▶ Managing the investor and analyst community
- ▶ Executing new initiatives
- ▶ Complying with public company regulations

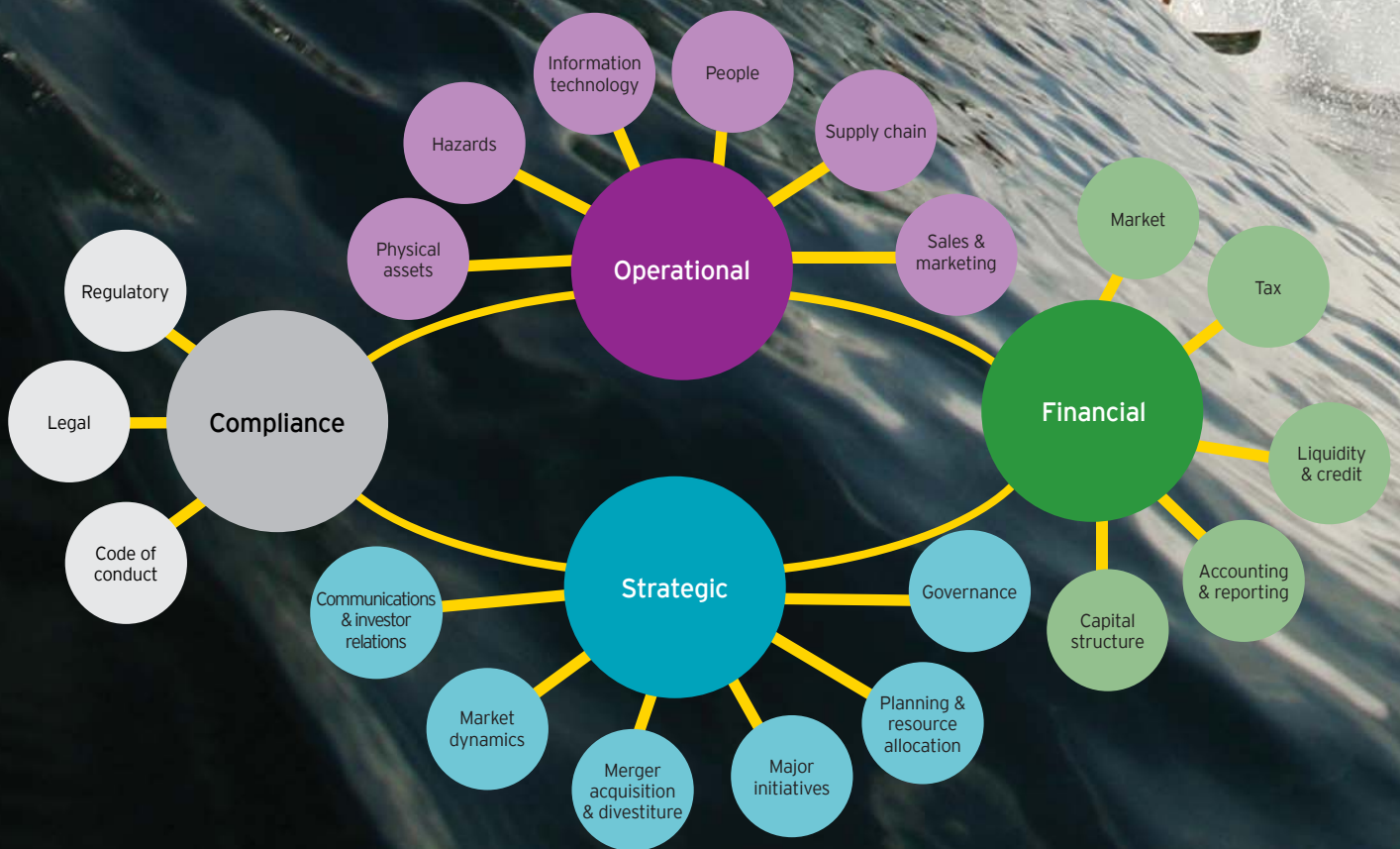
Investors will want to feel confident that the company understands the risks it faces and can manage and monitor them efficiently. But that is not all. They also need to trust in management's willingness and ability to communicate openly about risk management in general and what they are doing to improve.

Fine words alone will not satisfy investors. They will want proof that risks are being properly mitigated and assurance that the internal control structure is sound. The company needs to strike the right balance between keeping risks within acceptable limits while pursuing profitable opportunities as vigorously as possible. If the company is taking significant risks with investors' capital, it needs to compensate them with adequate returns.

Investors value good risk management. Our research indicates that four out of five investors would pay a premium for companies with a successful approach to risk management. But they will punish poor performers: two-thirds of investors told us they would avoid a company if they felt its risk management was not good enough; one-half of investors said they had sold shares in a company because they decided its risk management framework was weak.

Public company risk universe

This chart maps some of the new risks a business will face once it becomes a public company. Failure to manage them effectively can have serious consequences, including severe financial loss, damage to the company's competitive position, dramatic and unexpected business changes, and loss of momentum. At best, failure here will distract senior executives from their core goals. At worst, it could result in the demise of the business.



3.

Better risk management can improve business performance

Successful companies do not invest in risk management improvement simply to keep their external stakeholders happy. If executed correctly, a risk management program can be a driver of growth and business performance, enabling a company to take better-educated risks.

Indeed, risk management is not about just mitigating risks. Done well, it enables an organization to seize opportunities ahead of its competitors. That's why a commitment to excellent risk management involves more than just thinking harder about "what might go wrong."

A company that knows how to take risks in a more calculated and controlled manner than its rivals, customers or suppliers will be able to find sources of profitable value. Our research shows that 96% of company executives believe strong risk management has had a positive impact on their long-term earnings performance.

Companies that invest to improve their risk management can:

- ▶ Exert a stabilizing influence over their business operations
- ▶ Advance their strategy in a more controlled way
- ▶ Create a stronger, better managed business with more robust decision-making
- ▶ Make their business more attractive to investors
- ▶ Improve business performance by unlocking new sources of value



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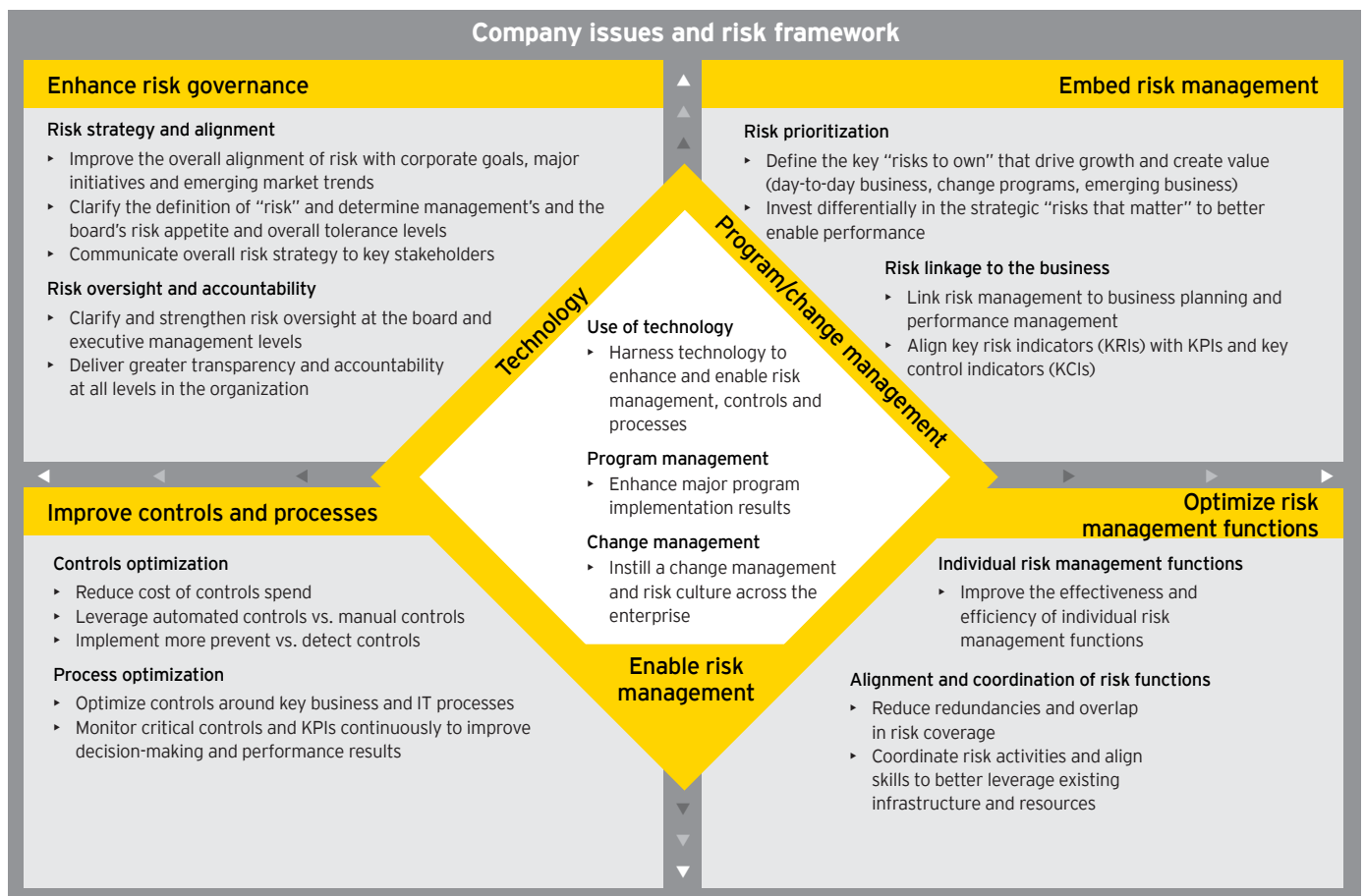
How to improve risk management

Any successful effort to review and improve the quality of risk management in an organization starts from the very top. The CEO, CFO and management should take ownership of risk, with the board taking an active oversight role. The days when a CEO could claim ignorance of what staff further down the organization were doing are gone – if they ever existed.

Effective risk governance should provide proper incentives for the board and management to pursue objectives in the best interest of the company and its stakeholders. At the same time, it should facilitate effective monitoring of risk within defined tolerances.

While the risk function is owned by upper management and the board, risk management is in the business and overseen by the company’s various risk and compliance functions. These specialist groups could include internal audit, IT risk experts, external audit, legal and regulatory, and a Chief Risk Officer.

Providing that these assurance, risk and control activities are in place and effective, and then aligning and coordinating their activities, is an important element of good risk management. They are all important in their own right, but their value to the business can increase enormously when they are working in harmony. The total risk management process will then contribute far more than the sum of its parts.



5.

What better risk management looks like

1 Lead with the tone at the top

Communicate clear policies and procedures. An effective risk management framework starts at the very top of the organization and enables the business to approach the future with confidence.

2 Have robust corporate governance

This is essential for all newly listed businesses in their time of great change. The organization must have a strong risk management and internal control environment. Investors are paying much closer attention to how companies approach compliance and corporate governance.

3 Do not surprise the market

The market reacts negatively to surprises. Even positive ones can suggest to investors that the board's control over the business is not what it should be. An effective risk management program can help reduce the risk of surprises.

4 Set realistic financial targets

A newly listed business needs to set and meet expectations on financial performance if it is going to accelerate its growth. Goals must be realistic, clearly communicated and tied to risk management.

5 Stay ahead of changing regulations

A newly listed business has to comply with a host of new regulations, legislation and filing deadlines. A key component of an improved risk management program will be better corporate and regulatory compliance.

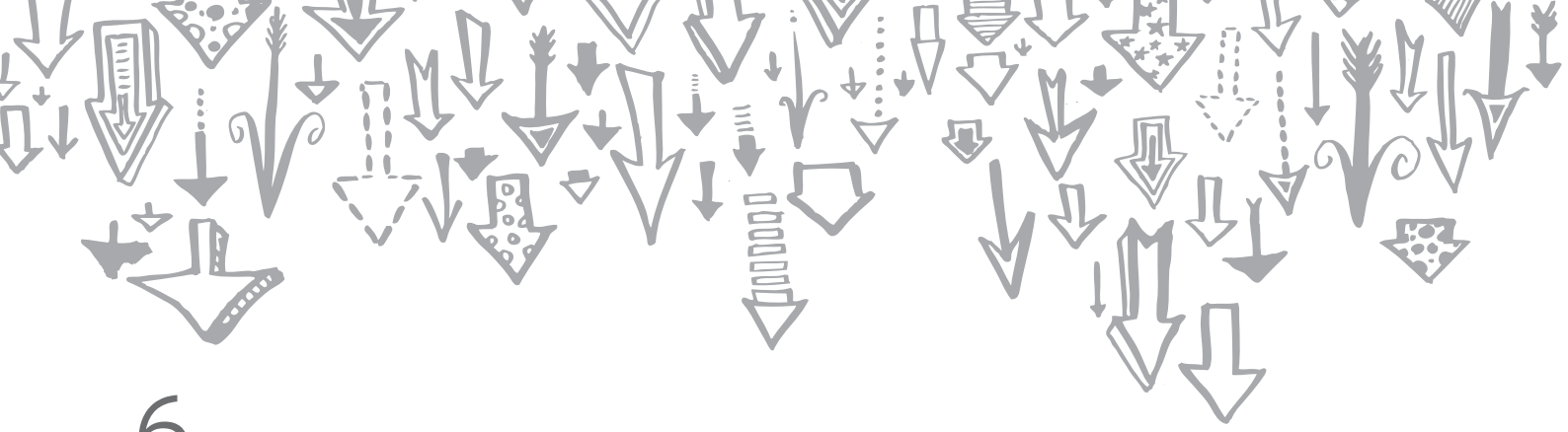
6 Consider risk at the beginning

Risk should be considered during the strategic decision-making process, not the end. Early understanding of planning and resource risks will enable a better focus on business investments. Companies that consider the likely response of competitors and the potential for third-party risks are better able to identify opportunities for competitive advantage.

7 Identify emerging risk issues

Strategic uncertainties arise from emerging risks that have the power to threaten the current business model. The business needs to consider emerging risk throughout its value chain, including suppliers, customers, partners and key stakeholders.





6.

How does your organization's risk management program measure up?

Better risk management does not necessarily mean more complicated risk management. For the newly listed business with limited resources, the right approach can be to keep things simple, at least at the start.

To improve its approach to risk management, an organization needs to understand the risks that could hamper its achievement of business objectives and find effective ways to respond to them. But managing risk is not something that management does just once. It should be an integral part of the business – something that is monitored and enhanced regularly.

The checklist at right provides a quick way to assess whether a business has the necessary elements of a good risk management framework in place. A tick in a “no” or “don’t know” box indicates an important gap in the organization’s approach to risk – such gaps should be addressed as a matter of urgency.

Items that receive a “yes” tick should be scheduled for further review. It is important to demonstrate that these elements of the risk management framework are working as intended and that opportunities for improvement are being identified. Action here can help the business to gain even greater value from its risk management efforts.

	Yes	No	Not sure
▶ Do you have a formal risk management framework?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Have you clearly defined your risk appetite?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Do you perform an annual enterprise-wide risk assessment?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Are processes in place so that risk management is aligned to corporate strategies?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Yes	No	Not sure
▶ Do your risk and compliance functions throughout the organization work together?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Do your risk functions focus on the most important risks?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Do your risk functions improve your business performance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Does your internal audit department have a clear mandate that addresses strategic, operational, financial and compliance risk?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Yes	No	Not sure
▶ Have you established clear governance over risk and risk management?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Have you defined board committees with a focus on specific risk areas and considered the appropriateness of a risk committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▶ Do you clearly articulate your risk assessment and risk management processes to the public markets?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Improved risk management will not only provide better protection for an organization's business, but can also improve business performance, decision-making and ultimately competitive advantage.



Working with Ernst & Young

How can we help?

At Ernst & Young, we understand the challenge of taking a private company public. An IPO is a tremendous opportunity to accelerate the growth of a business. Whether it has recently completed an IPO or is still in the process of preparing, we can ease the adjustment to life as a public company. We've guided more companies through an IPO and beyond in the last five years than any other public accounting organization.

A global leader in risk advisory services

As a global market leader in risk advisory services, we help newly listed businesses to gain confidence that they have identified and understood their main risks and that these risks are managed effectively.

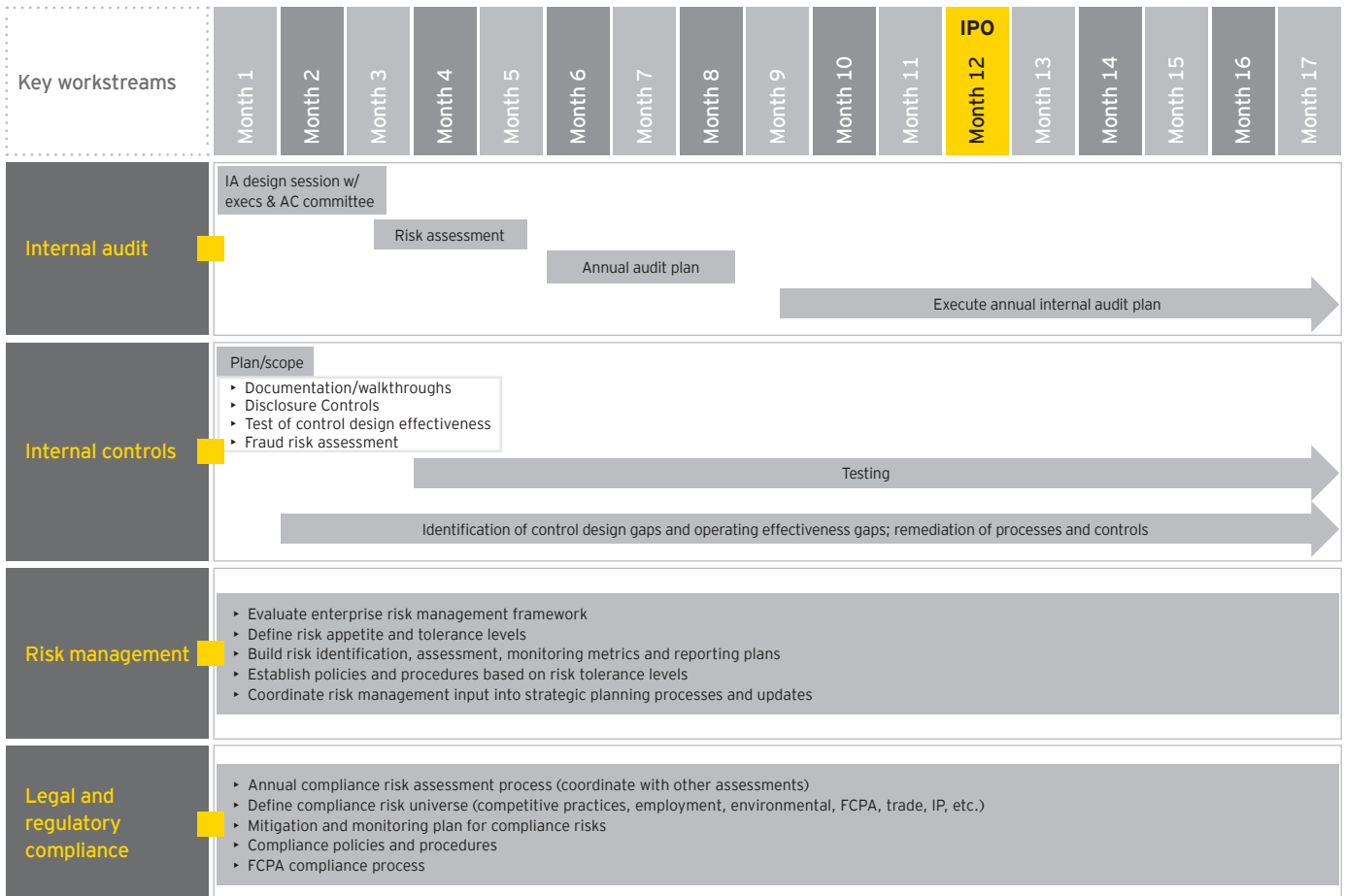
We work with companies to help them get past the hype that too often surrounds risk management. There is no value in creating

an unworkable "risk bureaucracy." Our focus is on helping the business to manage and control its risks. That way management can focus time on the core priorities that will move the business forward: delivering strategy, improving performance and accelerating growth.

How we can help:

- ▶ Develop a risk management framework
- ▶ Establish an internal audit function
- ▶ Enhance your internal control environment
- ▶ Align risk and compliance functions
- ▶ Execute a risk management program

If you'd like us to help your business address any of these challenges, please get in touch.



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